No. 95-155

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

IN RE WORLDS OF WONDER SECURITIES LITIGATION

DELOITTE & TOUCHE LLP,

Petitioner,

v.

ROSETTA MILLER; WALTER UNTERMEYER; ALAN NISSELSON; TRUDY WHITMAN NISSELSON; PAUL GREENSTEIN; HOWARD H. WESTON, AS TRUSTEE FOR THE FLORIDA MUNICIPAL, INC., RESTATED DEFINED BENEFIT TRUST AND PLAN; and SYLVIA WIND, on behalf of themselves and the certified class of purchasers of the securities of Worlds of Wonder, Inc.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

Certiorari is clearly warranted in this case, and nothing in Respondents' opposition suggests otherwise. Indeed, rather than dispute the importance of the issues raised by Deloitte's petition, Respondents' arguments confirm the polarization regarding the proper test for loss causation under Section 11(e), and underscore the need for its resolution by this Court.

For example, Deloitte, the District Court and the Second Circuit in *Akerman*, among others, hold that there can be no loss causation – no damages "resulting from" – the misstatement at issue if the misstatement is not disclosed. Respondents and the Ninth Circuit, on the other hand, state that an unknown misstatement can cause a depreciation in a security's value if the misstatement somehow "touches upon" the reasons for the decline in value.

There is similar conflict and uncertainty over whether the Ninth Circuit properly imported judge-made Section 10(b) causation theory to define statutory loss causation under Section 11(e). Deloitte and its authorities say that the Ninth Circuit acted improperly, and that it was obliged to adhere to the plain terms of Section 11, rather than policy-driven, judicially created doctrines borrowed from a broad, judicially implied cause of action. Respondents, on the other hand, note this Court's statement that the securities laws are "interrelated" and apply "cumulatively," and conclude that therefore these very different statutes should be interpreted the same way.

Thus, this case presents a clear question of federal law, and even Respondents do not dispute the importance of that question. Nor does that question depend on any purported factual "disputes," as Respondents suggest. The focus here is the proper legal standard, not the state of the record.

Accordingly, certiorari should be granted.

I. THE INTERPRETATION OF THE LOSS CAUSATION PROVISION OF SECTION 11 PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW THAT SHOULD BE SETTLED BY THIS COURT

Respondents raise three arguments in opposition to Deloitte's petition. None disputes the importance of the federal question presented, or otherwise justifies the denial of certiorari in this case.

A. Deloitte's Interpretation of Section 11(e) Is Consistent With The Language Of The Statute And The Intent Of Congress

Respondents contend that Deloitte's (and the District Court's) interpretation of Section 11 contradicts the express language and purpose of the statute. *See Brief In Opposition To Deloitte & Touche LLP's Petition* ("Opp.") at 23. In fact, it is the other way around. It is the Ninth Circuit's interpretation that is clearly at odds with the plain language and intent of Section 11.

Section 11(e) on its face limits damages to the decline in value "resulting from" the "part of the registration statement with respect to which . . . liability is being

asserted" – here, WOW's fiscal 1987 financial statements. 15 U.S.C. § 77k(e) (App. D-5). Courts have consistently construed "resulting from" to require that the misstatement directly cause the plaintiffs' losses, not merely *"touch upon"* the reasons for the investment's decline. *See In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850, 877 (N.D. Cal. 1993) (*"WOW I"*) (App. B-64); *In re Fortune Systems Sec. Litig.*, 680 F. Supp. 1360, 1365 (N.D. Cal. 1987) (loss causation requires that the damages be the "direct result of the misrepresentations or omissions"); *Lyne v. Arthur Andersen & Co.*, 772 F. Supp. 1064, 1067 (N.D. Ill. 1991) (plaintiffs must show that "their damage directly resulted from the defendants' wrongdoing").[1]

Common sense tells us that where, as here, the market never learns of the existence of a misstatement, it never becomes part of the total mix of information on

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[1] Accordingly, Respondents are wrong to assert that "no court (other than the district court below) has ever adopted" the interpretation of loss causation Deloitte advocates in its Petition. *See* Opp. at 27. Moreover, Respondents' authorities do not support a broader construction of loss causation under Section 11(e) than that advocated by Deloitte. *See* Opp. at 27 n.17. *Walco Investments, Inc. v. Thenen*, 881 F. Supp. 1576, 1584 (S.D. Fla. 1995) is inapposite, since it involved Section 10(b), not Section 11. *Westinghouse Elec. Corp. v. 21 International Holdings, Inc.*, 821 F. Supp. 212 (S.D.N.Y. 1993) is not instructive. The company announcement that raised a triable issue of causation in that case is not set forth, and is only vaguely described as concerning a charge to earnings due to unspecified problems at a subsidiary. *Id.* at 214, 220. *In re Fortune Systems Sec. Litig.*, 680 F. Supp. at 1365-66, 1368, is not even remotely supportive of Respondents' position, since it held, as did the District Court in *WOW I*, that the market could not react to the alleged omissions until it actually learned of them.

which an efficient market determines price, and cannot possibly "cause" the market to depreciate the value of the securities. For that reason, the District Court, and many other courts, have held that there is no causation in the absence of such disclosure. *See WOW I*, 814 F. Supp. at 866-867 (App. B-37) ("Since the marketplace never knew of any alleged accounting errors, the alleged errors cannot be said to have had any effect on the Debentures' market value."); *see also Akerman v. Oryx Communications, Inc.*, 810 F.2d 336, 342 (2d Cir. 1987) ("The price decline before disclosure [of the misstatement] may not be charged to defendants."); *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 859 F. Supp. 743, 751 (S.D.N.Y. 1994) ("It is true that a 'price decline before disclosure may not be charged to defendants.'"); *Fortune*, 680 F. Supp at 1365-1366, 1368 (market could not react to alleged omissions until they were actually learned of).

These holdings are consistent with both the "resulting from" language of Section 11(e) and Congress' intent to limit the otherwise harsh provision of strict liability under that statute:

> In order to balance the harsh, strict liability features of Section 11, Congress expressly has limited the damages to those directly caused by the defendant's misleading conduct. The remedy and the loss causation defense are provided by statute, and stand in stark contrast to the judge-made remedy for Rule 10b-5 violations.

WOW I, 814 F. Supp. at 877 (App. B-64). In short, where strict liability may be imposed, a "no harm, no foul" causation standard makes sense.

Thus, the Ninth Circuit's expansive "touch upon" test ignores this Court's admonition in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439, 1448 (1994) to adhere strictly to the text of the federal securities laws in defining the conduct covered by those laws, *see* Petition at 16-20, and the intent of Congress.[2]

Respondents warn that a narrow construction of loss causation would "eviscerate" Section 11, by allowing wrongdoers to escape liability "simply by refusing to admit that their previous representations were false." Opp. at 6; *see id.* at 22-23.

To the contrary, it is the "touch upon" test that guts the statute of all meaning, ignores the explicit "resulting from" language of the statute, and unacceptably broadens liability against issuers, underwriters and accountants. *See* Petition at 14-16. Nor will investors be without a remedy merely because Section 11 is interpreted as Congress intended. If relief under Section 11 is unavailable because the misstatement in the registration statement was not disclosed to the market, the undisclosed misstatement nevertheless may be actionable under Section

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[2] Other than the Ninth Circuit's holding in *WOW II*, Respondents' contention that "the concept of causation is the same under both [Section 11 and Section 10(b)]," and is "simply proximate causation," is unsupported by any authority. Opp. at 28, 29. To the contrary, Deloitte's authorities make clear that the elements and remedies of the various securities laws are not interchangeable, and must instead be construed on a particularized basis according to the specific language of the statute in question. *See* Petition at 18-20. Respondents have not distinguished or even addressed those authorities.

10(b), or other statutory or common law doctrines of fraud, deceit or negligent misrepresentation.

Indeed, Respondents' professed concern relies on a fundamental mischaracterization of Deloitte's position. Deloitte has never contended that defendants must explicitly admit wrongdoing to establish causation. *See* Opp. at 3, 6, 23, 26. To the contrary, Deloitte simply contends that the court must adhere strictly to the language of the statute; and that whatever the form in which the disclosure is made to the market – whether by the defendant or someone else, whether an admission of fault, a restatement of financial statements, a disclosure in a newspaper, trade publication or securities analyst's report, or merely an announcement of an error – the only recoverable damages are those "resulting from" the alleged misrepresentation in the registration statement, and not those that merely "touch upon" it. *See WOW I*, 814 F. Supp. at 877 (App. B-64) ("Of course, it is not necessary for Deloitte to admit publicly that it made errors in the Debenture Prospectus for the jury to find disclosure of the errors to the market.")

Here, no disclosure of any kind by anyone ever occurred. None of the WOW disclosures, including those cited at length by Respondents, refers to WOW's financial statements or the existence of any alleged errors in them. *See* Opp. at 12-14. The layoffs announced on October 16, 1987, for example, do not suggest that the financial statements were misstated, nor does the Company's disclosure of a cash shortage in 1988 indicate that the Company had improperly recognized revenue in 1987.

Therefore, any decline in value of the debentures following those disclosures did not "result from" the alleged errors in the financial statements.

B. The Ninth Circuit's Decision Conflicts With *Akerman*

Respondents deny that there is a conflict between the decision below and the decision of the Second Circuit in *Akerman v. Oryx Communications, Inc.*, 810 F.2d 336 (2d Cir. 1987). Respondents claim that *Akerman* is "factually distinguishable," and that it does not address the type of disclosure necessary to constitute loss causation under Section 11(e). Opp. at 19-20. Respondents are wrong.

The *Akerman* plaintiffs sued under § 11 to recover the amount of the decline in the value of the company's stock occurring *both* prior to and subsequent to the company's public disclosure of an error in its financial statements. The Second Circuit held that "the price decline before disclosure may not be charged to defendants." *Akerman*, 810 F.2d at 342. The Ninth Circuit took precisely the opposite view; it expressly rejected as "faulty" the "premise that Deloitte's alleged errors [in WOW's financial statements] needed to be disclosed to the market before section 11 liability could attach." *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1422 (9th Cir. 1994) ("*WOW II*") (App. A-30). The conflict is clear. Indeed, it is express.

Thus, a clear and direct conflict between the holdings of the Ninth and Second Circuits remains as to whether an undisclosed error can satisfy the loss causation requirement of Section 11(e). The conflict requires this Court's resolution to secure a uniform rule concerning

loss causation to avoid the potential for confusion and inconsistent judgments.

C. The Purported Factual "Disputes" Raised By Respondents Have No Relevance To This Court's Resolution of The Correct Standard For Loss Causation Under Section 11(e)

Finally, Respondents argue that, even if the District Court correctly interpreted Section 11(e), Deloitte still would not be entitled to summary judgment because of the insufficiency of its evidence. In particular, Respondents claim that Deloitte misrepresented the record by stating that it was "undisputed" that WOW's announcements did not disclose the alleged accounting errors in the financial statements;[3] and claim that Deloitte's evidence correlated WOW's announcements with the price of WOW's *stock*, but not with the price of WOW's *debentures*. Opp. at 4-5, 17-19.

These are irrelevant diversions. This Court can determine the appropriate test for loss causation without resolution of the alleged factual "disputes" Respondents have raised. Even if true, these "disputes" concern only the state of the record, and a quarrel with the District Court's

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[3] Specifically, Respondents contend that the "undisputed fact" was rebutted by their expert, who "proved" that the WOW disclosures that triggered the decline in the debentures "directly related" to the false financial statements. Opp. at 18-19.

assessment of it. They come too late and they do not bear on the principle at issue.[4]

Respondents' contention that Deloitte purportedly provided only evidence correlating the WOW announcements with the decline in the *"price"* of the debentures, rather than their *"value,"* Opp. at 26, is yet another irrelevant quarrel with the District Court's determination of the sufficiency of the evidence, for it bears on the measure of damages under Section 11, not the test for causation. It has nothing to do with whether the Ninth Circuit was right to construe causation under Section 11 broadly to include anything that "touches upon" the reasons for that decline.[5]

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[4] In any event, the so-called disputes have no basis in the record. Both courts below found that there was no evidence that the alleged errors in the fiscal 1987 financial statements had been disclosed to the market. *See WOW I*, 814 F. Supp. at 867, 877-78 (App. B-37, B-66); *WOW II*, 35 F.3d at 1422 (App. A-31). Moreover, Deloitte's expert, Robert Stillman, filed a supplemental declaration specifically correlating WOW's announcements to the price of the debentures, and this evidence was before the District Court before its decision became final.

[5] The theoretical difference between "price" and "value" has no practical significance here in any event. Certainly the courts below did not find the difference important for purposes of determining loss causation – neither the Ninth Circuit nor the District Court even discuss the "price vs. value" dichotomy. The Ninth Circuit itself simply summed up the measure of Respondents' losses as "the decline in debenture *price*." *See WOW II*, 35 F.3d at 1423 n.5 (App. A-33 n.5) (emphasis added). Indeed, under the express terms of the statute, those Respondents who sold their securities before the suit was filed must look to the sales *price* of their debentures, rather than their value, to determine their damages. *See* 15 U.S.C. § 77k(e) (App. D-5) ("The

CONCLUSION

The petition should be granted.

Respectfully submitted,

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suit . . . may be to recover such damages as shall represent the difference between the amount paid for the security . . . and . . . (2) the price at which such security shall have been disposed of in the market before suit[.]"). Only those Respondents who held their debentures until after the suit was filed look to the *value* of the debentures. *Id.*